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No. 91-1135

In the Supreme Court of the United States

OCTOBER TERM, 1991

NEWARK MORNING LEDGER CO.,
AS SUCCESSOR TO THE HERALD COMPANY,
PETITIONER

v.

UNITED STATES OF AMERICA,
RESPONDENT.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF OF INVESTMENT COUNSEL ASSOCIATION OF AMERICA, INC. AS AMICUS CURIAE IN SUPPORT OF PETITIONER

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QUESTION PRESENTED

Whether the Petitioner Newark Morning Ledger Co. satisfied its burden of demonstrating to the trier of fact that certain newspaper subs ·ription lists it purchased in the acquisition of Booth Newspapers, Inc. were depreciable assets separate from goodwill.

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INTEREST OF AMICUS CURIAE

The Investment Counsel Association of America, Inc. ("ICAA") respectfully submits this brief as amicus curiae in support of the petitioner. The signed consents of the parties are filed with this brief.

The ICAA is a national professional association of investment advisory firms. The ICAA comprises more than 160 investment advisory firms that collectively manage client assets in excess of $410 billion. All ICAA members qualify to use the term "investment counsel" under Section 208(C) of the Investment Advisers Act of 1940, which restricts the use of this term to

firms whose principal business consists of acting as investment advisers and a substantial part of whose activities consists of providing investment management services to clients.

The principal business assets of a typical ICAA member organization are the investment advisory contracts which the firm enters into with its customers for the management of their investment assets. The contracts are evidenced by written agreements which are governed by federal and state securities laws and fiduciary standards. These contracts appoint the investment advisory firm as the client's authorized agent to manage the assets placed under the direction of the advisory firm and provide for the payment of advisory fees usually based on a percentage of assets under management. These advisory contracts represent a steady flow of income to the advisory firms. Upon the sale or purchase of such a business, purchasers have traditionally paid substantial amounts for these contracts. Under long-standing federal income tax principles, purchasers have recovered the cost allocated to these contracts over their estimated useful lives through depreciation deductions.

If the Solicitor General's broad interpretation of the Third Circuit decision in *Newark Morning Ledger Co.*[1] is accepted, this long-standing tax treatment could be placed in doubt.

SUMMARY OF ARGUMENT

Congress and the Administration are currently actively cooperating in the development of legislation which would provide that virtually all purchased intangibles, including goodwill, would be depreciated over fourteen years on a straight-line basis. This Court should reject the broad rule advanced by the Solicitor General and leave the fashioning of comprehensive depreciation rules to congressional action.

The Solicitor General's definition of goodwill as including all assets any part of whose value derives from continuing customer patronage contradicts settled case law. It could encompass many intangible assets, such as investment advisory contracts,

[1] *Newark Morning Ledger Co.* v. *United States*, 945 F.2d 555 (3d Cir. 1991).

which derive value from continued customer patronage but which, when the taxpayer has adequately shown a determinable life and value, have been held by the courts to be depreciable.

The definitional approach proposed by the Solicitor General produces illogical results and would substitute a standardless inquiry for the experience-based fact findings historically made by the courts for almost eighty years. It turns on such formalisms as contract term and portion of assets purchased, rather than business realities such as the time period over which an asset is known to waste.

The Third Circuit concluded that the district court had made an error of law and entered judgment for the government. It should have remanded the case for further proceedings under its view of the correct law.

ARGUMENT

I. The Solicitor General's Broad Interpretation Of *Newark Morning Ledger* Is An Invitation To Engage In Judicial Rulemaking That Would Preempt An Ongoing Legislative Process

The Solicitor General has invited this Court to adopt the new rule of decision that purchased intangible assets which derive value from ongoing customer patronage are, as a matter of law, nondepreciable goodwill, without regard to such assets' reasonably ascertainable life, value, or other characteristics. This definitional approach to the issue is a radical substitution of a *per se* rule for the traditional case-by-case factual inquiry mandated by the statute since 1913. Since its inception in 1913, the Internal Revenue Code has permitted as a deduction "a reasonable allowance for the exhaustion, wear and tear of property."[2] This inherently factual rule — extending to both tangible and intangible assets — requires an examination of the useful life

[2] Revenue Act of 1913, 38 Stat. 114, 172.

and value of the asset at issue.[3] The Solicitor General's definitional approach also conflicts with numerous decisions of the Tax Court and other lower courts allowing depreciation with respect to a wide array of intangible assets which derive value from ongoing customer patronage.

Such a sweeping change is appropriately left for congressional action. On several occasions, Congress has adopted statutory enactments governing the depreciation of tangible and some intangible assets in an effort to ease the burden of the case-by-case rule.[4] With respect to intangible assets generally, Congress and the Administration have recently been actively cooperating in the development of legislation which would provide that virtually all purchased intangibles, including goodwill, would be depreciated over fourteen years on a straight-line basis. This legislation would eliminate the need to determine whether a particular intangible asset is separate from goodwill and whether it has a determinable life.

The legislation was passed by Congress on March 20, 1992, but vetoed by the President the same day because he objected to other provisions of the conference bill.[5] Despite the Presi-

[3] Indeed, regulations first issued by the Treasury in 1919 provided:

> If, however, an intangible asset acquired through capital outlay is known from experience to be of value in the business for only a limited period, the length of which could be estimated from experience with reasonable certainty, such intangible asset may be the subject of a depreciation allowance, provided the facts are fully shown in the return or prior thereto to the satisfaction of the Commissioner.

Art. 163, Regs. 45 (1919 Prelim. ed.) H.R. Doc. No. 1828, 65th Cong., 3d Sess. (1919).

The pertinent regulation in force today is similarly worded. *See* Treas. Reg. §1.167(a)-3. In the 1919 regulation, goodwill was listed as an example of a nondepreciable intangible asset and patents and copyrights were listed as examples of depreciable intangible assets.

[4] *See e.g.*, Section 168 (tangible assets), Section 195 (start-up expenditures), and Section 1253 (certain acquired franchises).

[5] *See Tax Fairness and Economic Growth Acceleration Act of 1992* — Veto message from the President of the United States, 138 Cong. Rec. H1604 (Mar. 24, 1992). As passed by Congress, the bill contained a retroactivity provision permitting taxpayers to elect to amortize intangible property over seventeen years in taxable years that were open on July 25, 1991, unless a year subsequent to the open year was closed on that date. The legislation would apparently not apply to the Petitioner in this case.

dent's veto of H.R. 4210, Treasury Assistant Secretary Goldberg testified on April 28, 1992, that the Administration continues its strong support for fourteen-year depreciation for intangibles.[6] Unlike the definitional approach advocated by the Solicitor General, which will entangle the courts in an essentially standardless, "know-it-when-we-see-it" search for goodwill, the legislation offers the prospect of ending the controversy by eliminating the need to engage in the admittedly difficult factual analysis required in intangible asset cases. This Court should reject the broad rule advanced by the Solicitor General and leave the fashioning of comprehensive depreciation rules to congressional action.[7]

II. The Solicitor General's Definition Of Goodwill As Including The Value Of All Income From Continuing Patronage Conflicts With Settled Case Law

Perhaps the greatest irony of the decision in *Newark Morning Ledger* is the Third Circuit's assertion that it was reversing the district court based on a reluctance "to take it upon ourselves to announce a sudden redefinition of a concept so fundamental to tax accounting."[8]

Sudden redefinition is precisely what the Third Circuit decision would accomplish if allowed to stand uncorrected and unlimited. The Third Circuit held that:

[6] Copies of Secretary Goldberg's testimony have been lodged with the Court and served on the Petitioner and the Respondent.

[7] As in all recent tax legislation, revenue constraints must be observed. Abandonment of a case-by-case approach in favor of the definitional approach sought by the Solicitor General could destabilize the revenue assumptions on which the legislation is based and could threaten the legislation's viability. For these reasons, this Court might, in the exercise of its sound discretion, choose to defer decision in this case until the conclusion of the legislative effort in either the current or the 1993 session of the Congress.

[8] 945 F.2d at 568.

there are some intangible assets which, notwithstanding that they have wasting lives that can be estimated with reasonable accuracy and ascertainable values, are nonetheless goodwill and nondepreciable.[9]

Although the Third Circuit purported to follow the Fifth Circuit's 1973 decision in *Houston Chronicle Publishing Co.* v. *United States*, its pronouncement cannot be reconciled with that case. In *Houston Chronicle*, the court made clear that the case law

> does not establish a *per se* rule of nonamortizability in every case involving both goodwill and other intangible assets.
>
> • • •
>
> The "mass asset" rule does not prevent taking an amortization deduction if the taxpayer properly carries his dual burden of proving that the intangible asset involved (1) has an ascertainable value separate and distinct from goodwill, and (2) has a limited useful life, the duration of which can be ascertained with reasonable accuracy.[10]

The *Houston Chronicle* holding that depreciation is available if the taxpayer can make the necessary factual showing had

[9] *Ibid.*

[10] *Houston Chronicle Publishing Co.* v. *United States*, 481 F.2d 1240, 1249-50 (5th Cir. 1973), *cert. denied*, 414 U.S. 1129 (1974). The Fifth Circuit stated quite specifically that there was no *per se* rule of non-amortizability in cases "involving both goodwill and other intangible assets." In fact, 17% of the purchase price in *Houston Chronicle* was allocated to purchased goodwill. 481 F.2d at 1244. Thus, the attempts by the Third Circuit and the Solicitor General (945 F.2d at 562, Solicitor General's brief on petition for certiorari at n.8) to distinguish *Houston Chronicle* on the ground that it involved no goodwill because the newspaper purchased ceased publication do not accord with the Fifth Circuit's view of its own decision or with subsequent decisions by that circuit and its successors. *Laird* v. *United States*, 556 F.2d 1224 (5th Cir. 1977), *cert. denied*, 434 U.S. 1014 (1978); *Citizens & Southern Corp.* v. *Commissioner*, 91 T.C. 463 (1988), *aff'd per curiam*, 919 F.2d 1492 (11th Cir. 1990).

been, prior to the Third Circuit's decision in this case, universally accepted by the courts.

The Third Circuit is simply wrong in announcing that "the Service has consistently advanced" the definitional approach sought by the Solicitor General in this Court.[11] For example, just one year after *Houston Chronicle*, the Service reconsidered two Revenue Rulings which had asserted that acquired insurance policies and insurance expirations were indistinguishable from goodwill as a matter of law.[12] In Rev. Rul. 74-456, 1974-2 C.B. 65, the Service stated that the 1965 rulings were modified

> to remove any implication that customer and subscription lists, location contracts, insurance expirations, etc., are, as a matter of law, indistinguishable from goodwill possessing no determinable useful life. The depreciability of assets of this nature is a factual question, the determination of which rests on whether the taxpayer establishes that the assets (1) have an ascertainable value separate and distinct from goodwill, and (2) have a limited useful life, the duration of which can be ascertained with reasonable accuracy.

The Solicitor General's position in this case is clearly a rejection of the long-standing principles enunciated in *Houston Chronicle* and accepted by the Service in Rev. Rul. 74-456.[13]

[11] 945 F.2d at 568.

[12] Rev. Rul. 65-175, 1965-2 C.B. 41; Rev. Rul. 65-180, 1965-2 C.B. 279.

[13] Although the Third Circuit cited Rev. Rul. 74-456, the opinion gave no indication that the court understood that Rev. Rul. 74-456 was issued for the express purpose of rejecting the *per se* rule that the Third Circuit has now adopted. The Solicitor General's Brief on the Petition for Certiorari ignores Rev. Rul. 74-456.

III. The Solicitor General's Interpretation Of *Newark Morning Ledger* Is Overbroad And Could Encompass Intangible Assets Such As Investment Advisory Contracts Which Are Clearly Amortizable

The Solicitor General's interpretation of *Newark Morning Ledger* identifies a single factual characteristic — whether an asset derives value from continuing patronage — and concludes that any asset with that characteristic is, by "definition," goodwill. Also, under the Solicitor General's interpretation, all terminable-at-will contracts are considered to derive value from continued customer patronage and therefore are conclusively presumed to be non-amortizable goodwill.

Many business assets (tangible and intangible) derive a substantial portion of their value from continued customer patronage. As a result, the Solicitor General's approach has the necessary effect of sweeping a broad range of assets into the category of nonamortizable goodwill, including those which are recognized as depreciable by regulation and other Internal Revenue Service pronouncements. Indeed, the very examples of amortizable intangibles given by Treasury Regulations §1.167 (a)-3 — copyrights and patents — clearly derive value from customer patronage and, under the logic of the Solicitor General's rule, would become nondepreciable.

The Solicitor General's definitional approach could also potentially reach investment advisory contracts, a result that concerns amicus curiae ICAA. Since advisory contracts, as a result of almost universal practice, provide for termination by either party on relatively short notice (e.g., 30 or 60 days), they conceivably could be classified as nonamortizable simply because of this *single* characteristic.

The determination of whether an investment advisory contract is depreciable requires a review of its many factual characteristics. Each contract is evidenced by a written agreement and can be separately identified. Contracts differ from one another and impose different obligations on the investment advisory

firm depending on the various circumstances of the individual clients. The contracts typically involve the management of substantial sums and are not terminated without substantial administrative cost and effort. Investment advisory firms are subject to a broad range of oversight designed to monitor the relationship between the client and firm and to preserve full and fair disclosure, trust, and confidence.[14] The investment advisory contract represents a stable relationship which experience and extensive statistical analysis indicate will typically last for a predictable period of time. Because of the stability of these contractual relationships, substantial value is usually assigned to the contracts in the acquisition of an investment advisory firm, and the buyer proceeds on the long-standing assumption that the cost of acquiring these contracts can be recovered through amortization deductions over their estimated useful lives.

These contracts resemble in every respect a long-term contract of the sort traditionally regarded as separable from goodwill. Nevertheless, the Solicitor General's analysis is susceptible to an interpretation under which the mere fact that the contracts are terminable on short notice can cause them to be automatically treated as goodwill. Whatever the Court's conclusion with respect to the particular facts presented in the Petitioner's case, it should preserve the ability of the lower courts to resolve cases involving investment advisory contracts and other similar assets on the basis of a full factual record.

Investment advisory contracts are only one of many assets in addition to newspaper subscribers that the Solicitor General's approach could reach. For example, mortgage servicing contracts, the principal asset of a substantial sector of the business community, could be affected. These contracts are written

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[14] These include the Employee Retirement Income Security Act (29 U.S.C. §1001 *et seq.*), the Investment Advisers Act of 1940 (15 U.S.C. §80b-1 *et seq.*), the Securities Act of 1933 (15 U.S.C. §77a *et seq.*), the Securities Exchange Act of 1934 (15 U.S.C. §78a *et seq.*), the Investment Company Act of 1940 (15 U.S.C. §80a-1 *et seq.*), the Commodity Exchange Act (7 U.S.C. §1 *et seq.*), the Rules of the Municipal Securities Rulemaking Board (15 U.S.C. §78o-4; 17 C.F.R. §240.0 *et seq.*), and state securities regulations.

agreements in which one party agrees to service mortgage loans generated by the mortgagee. The agreements are usually terminable on relatively short notice. Although the contracts derive value from continuing patronage, courts have consistently ruled that they are separate from goodwill and amortizable. *Western Mortgage Corp.* v. *United States*, 308 F.Supp. 333 (C.D. Cal. 1969); *First Pa. Banking & Trust Co.* v. *Commissioner*, 56 T.C. 677 (1971), *acq.*, 1972-2 C.B. 2; *Securities-Intermountain, Inc.* v. *United States*, 460 F.2d 261 (9th Cir. 1972); *First Nat'l Bank of Omaha* v. *Commissioner*, 34 T.C.M. (CCH) 360 (1975).

Other examples within the reach of the Solicitor General's approach include a variety of intangible assets acquired as part of a going concern which derive value from continued customer patronage: television network affiliation contracts,[15] cable television franchises,[16] animal hospital patient records,[17] loan contracts,[18] credit information files,[19] covenants not to compete[20] insurance expirations,[21] fuel oil customer lists,[22] core deposits of banks,[23] athlete and entertainer contracts,[24] highway advertising service contracts,[25] linen and towel supply business customer lists,[26] wholesale grocer's franchise contracts with retail grocers,[27] patents,[28] Muzak location contracts,[29] and bus franchises.[30] Courts have held all of these assets to be depreciable where the taxpayer has adequately shown a determinable life and value.

[15] *Meredith Broadcasting Co.* v. *United States*, 405 F.2d 1214 (Ct. Cl. 1969).

[16] *Chronicle Publishing Co.* v. *Commissioner*, 67 T.C. 964 (1977), appeal dismissed, (9th Cir. Dec. 22, 1977).

[17] *Los Angeles Central Animal Hospital, Inc.* v. *Commissioner*, 68 T.C. 269 (1977).

[18] *Commissioner* v. *Seaboard Finance Co.*, T.C. Memo 1964-253, *aff'd*, 367 F.2d 646 (9th Cir. 1966).

[19] *Computing & Software, Inc.* v. *Commissioner*, 64 T.C. 223 (1975), *acq.*, 1976-2 C.B. 1.

[20] *Warsaw Photographic Associates, Inc.* v. *Commissioner*, 84 T.C. 21 (1985); Rev. Rul. 68-636, 1968-2 C.B. 92.

[21] *Richard S. Miller & Sons, Inc.* v. *United States*, 537 F.2d 446 (Ct. Cl. 1976).

[22] *Holden Fuel Oil Co.* v. *Commissioner*, 31 T.C.M. (CCH) 184 (1972), *aff'd*, 479 F.2d 613 (6th Cir. 1973).

[23] *Citizens & Southern Corp.* v. *Commissioner*, 91 T.C. 463 (1988), *aff'd*, 919 F.2d 1492 (11th Cir. 1990).

[24] *Laird* v. *United States*, 556 F.2d 1224 (5th Cir. 1977), *cert. denied*, 434 U.S. 1014 (1978); *KFOX, Inc.* v. *United States*, 510 F.2d 1365 (Ct. Cl. 1975).

[25] *North American Service Co.* v. *Commissioner*, 33 T.C. 677 (1960).

IV. The Definitional Approach Urged By The Solicitor General Produces Illogical Results

The rule urged by the Solicitor General is based on the fallacious assumption that there is a clearly bounded class of assets which constitutes goodwill and another clearly bounded class of assets that is not goodwill under the same definition. The record before the Third Circuit and before this Court is confined to a single asset, namely the subscription lists of a specific group of newspapers, and thus does not provide an adequate basis for testing that hypothesis. In fact, however, the real world of intangible assets presents no such clear boundary lines.[31]

[26] *National Service Industries, Inc.* v. *United States*, 379 F.Supp. 831 (N.D. Ga. 1973).

[27] *Super Food Services, Inc.* v. *United States*, 416 F.2d 1236 (7th Cir. 1969).

[28] *Hyatt Roller Bearing Co.* v. *United States*, 43 F.2d 1008 (Ct. Cl. 1930).

[29] *Business Service Industries, Inc.* v. *Commissioner*, 51 T.C.M. (CCH) 539 (1986).

[30] *Pasadena City Lines, Inc.* v. *Commissioner*, 23 T.C. 34 (1954), *acq.*, 1955-1 C.B. 6.

[31] Indeed, the most significant distinction between goodwill and intangible assets found to be depreciable is that goodwill has an indeterminate life. Courts which have discussed the question of *why* goodwill should be non-depreciable have cited indefinite life as the rationale. *See, e.g., Dodge Brothers* v. *United States*, 118 F.2d 95, 100 (4th Cir. 1941); *Richard S. Miller & Sons, Inc.* v. *United States*, 537 F.2d 446, 450-54 (Ct. Cl. 1976); *Illinois Cereal Mills, Inc.* v. *Commissioner*, 46 T.C.M. (CCH) 1001 (1983), *aff'd*, 789 F.2d 1234 (7th Cir.), *cert. denied*, 479 U.S. 995 (1986); *Rost* v. *United States*, 371 F.Supp. 670, 671 (S.D. Tex. 1973). The Service itself spoke of "goodwill possessing no determinable useful life" in Rev. Rul. 74-456, *supra*. Only the

In his brief on the petition for a writ of certiorari, the Solicitor General rejects the taxpayer's argument that its subscription lists cannot be goodwill since they have a determinable useful life. The same thing, he says, "is true, and could be estimated by statistical experts, for the customers of any establishment,"[32] citing as his example a grocery store. But suppose, for example, that a grocery store has purchased contracts to supply several local businesses with their institutional grocery needs at a fixed mark-up over all costs and overhead and has records of purchases under each contract. If the contracts were for a term certain, say ten years, even the Third Circuit would apparently be prepared to recognize them as depreciable intangible assets. Certainly a purchaser would have little difficulty in demonstrating the separateness of such contracts. As this variation in facts demonstrates, the problem is one of proof, not of a bright line legal rule.

The Internal Revenue Code's depreciation provision, Section 167, requires factual inquiry, not into the manipulable legal formalism of contract term, but rather into the taxpayer's actual experience with the asset.[33] But under the Solicitor General's approach, depreciability would turn on whether the contracts were for a term certain or at will — not on the taxpayer's actual experience with the contract. This novel "rule" is even less helpful in resolving whether term contracts with early termination clauses fall on the depreciable side of the demarcation.

Third Circuit in the case before the Court has held that an asset can be non-depreciable goodwill notwithstanding a fact-finding that it has an ascertainable useful life and value.

[32] Solicitor General's Brief on Petition for Certiorari at 10-11 and footnote 7.

[33] Treas. Reg. §1.167(a)-3 requires reference to experience to determine a depreciation allowance. *See Commissioner* v. *Seaboard Finance Co.*, 367 F.2d 646, 653 (9th Cir. 1966) in which the court held that loan contracts demonstrated by experience to endure five years were depreciable over five years notwithstanding the fact that the legal term of the contracts could not exceed three years. *See also Business Serv. Indus.* v. *Commissioner*, 51 T.C.M. (CCH) 539 (1986) (contracts for stated term of five years with option to renew amortized over 15 years, the actual lives of the contracts.)

The other limitation offered by the Third Circuit — that an intangible which would otherwise be "definitional goodwill" may be depreciable if it is not purchased as part of a going concern — is equally problematic. Under this approach, if A buys subscription lists and equipment from B, but does not buy B's trade name, A may depreciate the subscription list, but if A buys the whole business, A may not depreciate the subscription lists.[34] To state the "rule" this way is to anticipate the difficulties for the lower courts in the future were this Court to adopt it. Just how much, or how little, must A not buy in order to preserve entitlement to depreciation?

It will also be difficult for courts to harmonize the definitional approach with the Treasury Department's regulations under section 1060 of the Internal Revenue Code mandating the use of the residual method in determining the value of goodwill in acquisitions of trades or businesses. The Senate Finance Committee, at the time section 1060 was enacted, stated that:

> Under the residual method, the value of the goodwill and going concern value is the excess of the purchase price of the business over the aggregate fair market values of the tangible assets and the identifiable intangible assets other than goodwill and going concern value.[35]

Example 2 of the Treasury regulations, §1.1060-1T(g), clearly contemplates that a zero allocation of purchase price to the goodwill of a going business can occur under the residual method when the values of tangible and other intangible assets

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[34] Indeed, this limitation appears to have confused the Third Circuit itself since it attempted to distinguish the *Houston Chronicle* case on the ground that the newspaper there purchased did not continue. But the *Houston Chronicle* did acquire goodwill and 17% of the purchase price was allocated to it; the *Houston Press* subscribers became *Houston Chronicle* subscribers. 481 F.2d at 1244. Would it have made a difference in the case before the Court if the Petitioner had declared the acquired newspapers terminated and begun publication on the day after the acquisition under a new name?

[35] S. Rep. No. 313, 99th Cong., 2d Sess. 252 (1986).

are sufficiently high. In contrast, under the Solicitor General's definition, which designates as goodwill all intangible assets dependent upon income from recurring customer patronage, there should always be positive value for the goodwill of a business with recurring customers. If the Solicitor General's definitional approach to goodwill is adopted, the courts will have to sort out these contradictory allocation principles.

But the fundamental difficulty of the definitional approach is inherent in its basic concept. If the value of an intangible asset must be "*completely* independent" of repetitive customer patronage to escape classification as goodwill, then the rule is impossibly broad. Patents and copyrights, software and package designs, despite their recognition by the Internal Revenue Service as separate, depreciable intangible assets,[36] would logically be a part of goodwill under such an approach. The income streams on which the value of these intangible assets depends is itself typically dependent on recurrent customer purchases.[37] If the formulation were "*primarily* independent" of recurring customer patronage, the standard becomes even less clear and more subjective.

Adoption of the definitional approach would move courts from a difficult, but nonetheless familiar, manageable and

[36] *See* Rev. Proc. 69-21, 1969-2 C.B. 303 (computer software) and Rev. Proc. 90-63, 1990-2 C.B. 664 (package design costs). These assets are particularly likely to depend on recurrent customer patronage for their value. *See also* Rev. Rul. 67-379, 1967-2 C.B. 127 (player contracts) and Rev. Rul. 68-636, 1968-2 C.B. 92 (covenants not to compete).

[37] As the Third Circuit recognized, such a definition effectively precludes use of the income valuation method since the income stream of any business asset is always dependent to some degree on customer patronage. Restricting intangible asset valuation to the replacement cost method (the only basis recognized by the Third Circuit) is at odds with economic reality and good valuation practice. No willing seller of a successful patent would consider parting with valuable patent rights merely for cost reimbursement. The sale price will instead be based on the parties' evaluation of the future income stream attributable to the patent. Treating the patent's income stream as goodwill (rather than as the value of the patent itself) simply because its value derives from the recurring patronage of purchases of the patented product is to ignore the marketplace. This valuation problem does not differ for many other intangible assets.

comprehensible, inquiry — can a separate intangible asset be identified[38] and its life and value ascertained — to a largely standardless inquiry into whether the asset is the "essence" of goodwill. This novel approach would make irrelevant what has heretofore been the most critical inquiry in a depreciation case — whether an ascertainable life can be determined for the asset based on the taxpayer's experience.

V. Resolution Of This Case Does Not Require Articulation Of A New Legal Standard; The Case Can Be Resolved On The Narrow Grounds Of Whether The Taxpayer Satisfied Its Burden Of Proof Under The Facts-And-Circumstances Standard

The Third Circuit decision is susceptible of two interpretations — the broad, definitional approach advanced by the Solicitor General, and a much narrower approach that is truer to the long-standing facts-and-circumstances test.

As demonstrated above, the broad view advanced by the Solicitor General is problematic. It conflicts with long-standing case law; it substitutes judicial rulemaking for legislation; it potentially reaches a broad range of assets historically consid-

[38] The separateness inquiry and identification inquiry are the same. In both cases, the question is whether the particular income stream being valued is properly attributable to the asset in question. Tax Court Judge Cohen recently stated in concurring in *Citizens & Southern Corp.* v. *Commissioner*, 91 T.C. at 515-16:

> I have found *no* authority for the proposition that assets, intangible or tangible, are not separate and distinct from goodwill unless no part of their value is related to continued patronage of customers of an ongoing business. As the majority opinion demonstrates in its exhaustive analysis of relevant authorities, assets are frequently found to be eligible for amortization even though the price paid took into account the probable continuance of terminable business relationships . . . Tangible property, such as special purpose equipment, is unquestionably subject to depreciation even though its value may be enhanced by its use in an ongoing business. It seems to me that the requirement that an asset be separate and distinct means only that it must have a measurable value for a specific use.

ered depreciable and not before the Court in this case; and it produces unworkable and illogical results. The Third Circuit itself stated that it intended to follow the case law as announced by *Houston Chronicle* and that the Petitioner lost because it did not meet its burden of proof. Much of the language which the Solicitor General relies on for his broad interpretation is unnecessary to the Third Circuit's decision and should properly be treated as *dicta*.

Under a more restricted reading, the issue to be resolved is limited to whether the Petitioner satisfied its burden of demonstrating that the value of the acquired newspaper subscribers was separate from goodwill. The district court found as facts that the acquired newspaper subscribers possessed lives that were determinable with reasonable accuracy and had an ascertainable value that was separate from goodwill. The district court then concluded that the Petitioner was entitled to depreciate the value of the acquired subscribers over their estimated useful lives. The Third Circuit reversed the district court's judgment on the basis that one of the district court's findings was clearly erroneous — the finding that the value of the acquired subscribers was separate from goodwill.

According to the Third Circuit, the Petitioner advanced inadequate evidence on which to base this distinction. To demonstrate the distinction from goodwill the Petitioner had relied on a syllogism: that, if it could be shown the acquired subscribers had a limited life (a point which the Government conceded on appeal), then it must follow that the acquired subscribers were not goodwill. The Third Circuit did not accept this reasoning. Rather than remand the case for reconsideration in light of its decision that additional proof of separateness was required, the Third Circuit concluded that the record was sufficient to enter judgment for the Government. This conclusion was error. It is not the proper role of an appellate court to decide the case under its view of the correct law as if it were the trier of fact. *Pullman-Standard* v. *Swint*, 463 U.S. 273, 290-93 (1982) ("where findings are infirm because of an erroneous view of the law, a

remand is the proper course unless the record permits only one resolution of the factual issue"); *Kelley* v. *Southern Pacific Co.*, 419 U.S. 318, 331-32 (1974).

If this Court finds that the district court applied the correct legal principle in evaluating the facts before it, it follows that the decision of the district court should be affirmed. If this Court, however, should decide that the district court applied an incorrect legal principle in considering the facts before it, the case should be remanded to the district court for further action in accordance with the appropriate legal principle.

CONCLUSION

The Solicitor General's broad interpretation of the Third Circuit's decision conflicts with the well-settled facts-and-circumstances approach to determination of the depreciability of an intangible asset. The government's failure to join issue on the critical factual matters of life and value in the district court was directly responsible for the district court's decision for the Petitioner. Given the stipulations presented to that court as to life and the evidence adduced on value, the district court's decision was not clearly erroneous and should be reinstated.

In particular, this Court should not substitute a poorly defined legal presumption for factual inquiry into life and value. A concept which is so fundamental to proper income measurement as depreciation should not turn on legal formalisms such as contract term and how much or how little of a business is acquired by a taxpayer. The Solicitor General's formalistic approach is not grounded in precedent and is at odds with economic reality. This Court should reaffirm the *Houston Chronicle* holding that depreciation of intangibles is a factual issue, dependent on the proof in each case. This Court should preserve for Congress the same freedom of action with respect to its currently pending legislation on intangible assets as that body

enjoyed in resolving similar controversies which had earlier arisen with respect to tangible assets.

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